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# Facsimile Cover Sheet

**TO: DAVID S. GUZY**

**Company: MINERALS MANAGEMENT SERVICES**

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**Date: April 27, 1999**

**Pages including this 4**  
**cover page:**

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**Comments:**

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April 27, 1999

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SUBMITTED BY FACSIMILE

Comments on MMS Supplementary  
Proposal on Valuation of Crude Oil  
Produced on Federal Leases 30 CFR  
206, 63 FR 38355 (July 16, 1998)

Dear Mr. Guzy:

Exxon Company, U.S.A., a division of Exxon Corporation (Exxon), appreciates the Minerals Management Service "MMS" reopening of the comment period so that the industry and MMS could have further dialogue on ways to resolve issues with the proposed oil valuation rule. Exxon has participated in each phase of the rulemaking process through comments and attendance at workshops. Exxon also participated in the industry workgroup that brought forward solutions to many of the issues in the proposed rule. We support the ideas brought forward by the "joint trade association group" and refer you to the detailed comments of those groups during this comment period. Exxon will not reiterate those comments in full. However, Exxon would like to comment on areas not addressed in previous Exxon comments and give added emphasis to a few key issues addressed by the industry.

**Goals and Objectives**

The MMS has stated that it has proposed these changes to simplify the rules, provide flexibility to lessees, more accurately reflect market value, and provide certainty to both lessees and MMS. Other intentions of the MMS, as expressed in its February 5, 1998 News Release, are:

"Royalty must be based on the value of production at the lease . . . [t]he [proposed] rule provides for royalty payments based on no more than the value of production at the lease."

Although we disagree that the proposed rule in its current format meets those objectives, we concur that the finalized rule should meet these stated objectives. In fact, the essence of the proposed rule to date has been to establish valuation points downstream of the lease with inadequate adjustments for arriving at value at the lease. By incorporating the changes suggested by industry, the MMS can achieve its goals and stated intentions in the final rule.

Exxon's goal is and has been to pay royalties correctly and in accordance with its lease obligations. To achieve this goal, the MMS rules must be workable, the MMS must be willing to give appropriate binding guidance, and the rule must not conflict with existing statutes and lease obligations. In addition, the MMS should eliminate language that invites second-guessing of arm's length transactions.

### **Industry Proposed Solutions**

The industry proposed solutions eliminate no second guessing, require binding determination, and address comparable sales, transportation, location/quality differentials, and the definition of affiliate. Exxon is supportive of these solutions as a prospective method for paying royalties. We urge the MMS to "reengineer" the royalty payment process so that it facilitates the payment of the royalty correctly the first time. This can be accomplished through the addition of language that eliminates the agency's ability to second guess gross proceeds received in arm's length transactions. The MMS should also be required to provide binding valuation determinations. For non-arm's length transactions, Exxon supports a valuation methodology that includes an option to use comparable sales/purchases as a measure of value at the lease. Lastly, fair transportation allowances and other adequate adjustments are a prerequisite to any valuation method using a downstream starting point.

### **California Royalty Payment Issues**

Exxon supports the MMS' decision in the current version of the proposed rule not to discriminate against lessees by disallowing gross proceeds for those lessees that purchase oil. However, issues still remain regarding the appropriate method to use for non-arm's length transactions involving California production. The current MMS proposal to use a netback methodology from Alaska North Slope "ANS" spot prices is simply not appropriate.

Exxon suggests that MMS adopt a nation-wide menu of valuation options that includes a comparables sales/purchases option. A comparables sales program in California, as well as other areas, is a valid method of determining value at the lease for non-arm's length sales.

We have resisted index methodologies that do not represent the value of production at the lease. If the MMS insists on such methodologies for certain situations where there are no comparable sales, we urge the MMS to look to the "nearest" spot prices for crude streams with "like quality" rather than ANS. As stated by Exxon in its earlier comments on file with the MMS, ANS is dramatically different from the vast majority of crude streams produced from the State of California's federal lands both on and offshore. Exxon strongly urges the MMS to consider using either the San Joaquin Valley (SJV) or Kern River (KR) spot prices as a better starting point for an index methodology for non-arm's length sales in California. Although location and quality adjustments will still be necessary to reflect the value of production at the lease, both the SJV and KR indices represent crude oils that are much more comparable to the California federal crude streams. Unlike ANS, these two crude streams also have transportation alternatives similar to the California federal crude streams.

### **Transportation**

The MMS is being urged by industry to allow a more appropriate method for determining non-arm's length transportation allowances. Comments from the joint trade associations outline the myriad of reasons that the MMS should reconsider its proposal. Exxon urges the MMS to consider these comments carefully.

Exxon commends the MMS for revisiting the subsea transportation issue. We anticipate that the MMS will recognize that there are certain subsea situations that are inherently a transportation function that consequently should automatically qualify for transportation allowances. We look forward to the publication of guidelines on this issue.

In closing, we urge the MMS to incorporate the comments and solutions set forth by Exxon and the industry workgroup in adopting an oil valuation rule.

*W. L. Stone*